Endowment Fund Legislation

For endorsement by:
Board of Land Commissioners
As proposed by:
Endowment Fund Reform Review Task Force

Purpose Of Legislation

- **Makes technical adjustments to two sections of Code amended in 2004**
- **Intent of those amendments remains valid, but Task Force believes they are:**
  - – Ambiguous and complicated
  - – Risky in their future implementation
  - – Potentially unconstitutional ommissions

Reform Review Task Force

This legislation was developed by the Endowment Fund Reform Review Task Force, established by the governor in September, 2005 at the request of the Land Board

- Official and ex-officio members include senior staff from four of five Land Board members, JFAC, the EFIB, and the Dept. of Lands
- The legislation was endorsed by the Endowment Fund Investment Board on February 6 and the endorsement of the Land Board is requested
- The legislation was approved for printing by the House State Affairs Committee on February 8

Benefits of the Legislation

- Technical adjustments – no change to the intent of the existing statutes
- Clarifies administration of the endowment funds
- Reduces chance of shortfalls in endowment fund distributions
- Reduces likelihood of litigation to clarify meaning of existing statutes

Summary Of Legislation

- **Technical adjustments to 57-724 (RS15860)**
  - Clarify calculation of gains and losses to the permanent funds (inflation adjustment)
  - Clarify how and when losses to the Public School Endowment Fund must be made up by the state
- **Technical adjustments to 57-724A (RS15838)**
  - Delay implementation of a change in the definition of “earnings” by a year
  - Set the triggering event for the change separately for each endowment fund

Does not change original intent of the statutes

LEGISLATURE OF THE STATE OF IDAHO
Fifty-eighth Legislature Second Regular Session - 2006

IN THE ____________________

__________ BILL NO. __________

BY ____________________

AN ACT

RELATING TO INVESTMENT OF PERMANENT FUNDS; AMENDING SECTION 57-724, IDAHO CODE, TO REVISE THE METHOD FOR THE CALCULATION OF GAINS AND LOSSES; DECLARING AN EMERGENCY, PROVIDING A RETROACTIVE EFFECTIVE DATE AND PROVIDING APPLICATION.

Be It Enacted by the Legislature of the State of Idaho:

SECTION 1. That Section 57-724, Idaho Code, be, and the same is hereby amended to read as follows:

57-724. DETERMINATION OF GAINS AND LOSSES. (1) Gains. Gains to permanent endowment funds shall be determined by the investment board when the current market value of the permanent endowment fund as of the end of the fiscal year exceeds the gain benchmark market value of the permanent endowment fund. Gains for each permanent endowment fund shall be calculated as of June 30 of each fiscal year by subtracting the gain benchmark market value as of June 30 of such year, after all adjustments set out in this section, from the current market value of the permanent endowment fund as of the same June 30 date. The gain benchmark market value shall begin with the market value of the permanent endowment fund calculated as it existed on June 30, 2000, and shall be ~~modi-fied-on-June-30-of-each-subsequent-fiscal-year-by-the-percentage-change-in-the average--of-the-immediately-preceding-three-(3)-fiscal-years-of-the-unadjusted consumer-price-index-for-all-urban-consumers-as-issued-by--the--United--States department--of--labor;--and--by-the-addition-of-funds-deposited-as-a-result-of land-sales-and-mineral-royalty-payments~~ adjusted cumulatively as of June 30 of each fiscal year thereafter for inflation during the preceding year based on the unadjusted consumer price index for all urban consumers as published by the United States department of labor, hereafter referred to in this section as "CPI-U," and further adjusted for certain deposits of funds into the permanent endowment fund during the preceding year, such adjustments to be calculated as follows:

(a) Inflation Adjustment. The gain benchmark market value shall be adjusted for inflation as of June 30 of each fiscal year by multiplying the gain benchmark market value as of the commencement of business on July 1 of the preceding calendar year by the sum of one (1) plus the percentage change in the average CPI-U for the fiscal year then ending. The percentage change in the average CPI-U shall be a fraction, the numerator of which is the average CPI-U for the fiscal year then ending less the average CPI-U for the preceding fiscal year, and the denominator of which is the average CPI-U for the preceding fiscal year. The average CPI-U for each fiscal year shall be calculated by dividing the sum of the monthly CPI-U index figures for such fiscal year, July through June, by twelve (12).

(b) Deposit of Funds. After adjustment for inflation, the gain benchmark market value shall be further adjusted by adding the amount of funds deposited into the permanent endowment fund from and including July 1 of the preceding calendar year through and including the June 30 date of adjustment, from any of the following sources:

(i) Land sales proceeds not deposited into the land bank fund under section 58-133(2), Idaho Code;

(ii) Funds transferred from the land bank fund after expiration of the time frame under section 58-133(3), Idaho Code;

(iii) Mineral royalty payments; or

(iv) Such other deposits into the permanent endowment fund as are required by law or otherwise permitted to be added to the permanent endowment fund except for the following:

1. Deposits to make up for losses to the permanent endowment fund;

2. Deposits of earnings reserves if the state board of land commissioners directs that such deposit not be added to the gain benchmark market value; or

3. Other deposits, including bequests, to the permanent endowment fund if the depositor or grantor thereof directs that the deposit not be added to the gain benchmark market value.

(c) Gain Benchmark Floor. Notwithstanding any other provision of this section, in no event shall the gain benchmark market value fall below the permanent corpus balance. For purposes of this subsection, the permanent corpus balance shall be calculated by adding to the permanent endowment fund balance as of June 30, 2000, all deposits to the permanent endowment fund up to and including the June 30 date of adjustment, other than deposits resulting from the investment activities of the permanent endowment fund and deposits made to make up losses to the permanent endowment fund.

(2) Losses. Losses to permanent endowment funds shall be determined by the investment board when the market value of the permanent endowment fund as of the end of the fiscal year is less than the loss benchmark market value of the permanent endowment fund. The investment board shall calculate any annual loss as well as the cumulative loss for each permanent endowment fund as of June 30 of the fiscal year.

(a) Cumulative Loss. The cumulative loss for each permanent endowment fund shall be equal to the difference between the loss benchmark market value as of June 30 of the fiscal year, after all adjustments to the loss benchmark market value as set out below in this subsection (2), and the current market value of the permanent endowment fund as of the same June 30 date.

(b) Annual Loss. The annual loss for a fiscal year shall be equal to the increase, if any, of the cumulative loss as of June 30 of such fiscal year, compared to the cumulative loss as of June 30 of the preceding fiscal year.

(c) Loss Benchmark. The loss benchmark market value for each permanent endowment fund shall begin with the market value of the permanent endowment fund calculated as it existed on June 30, 2000, and shall be ~~modified on--June-30-of-each-subsequent-fiscal-year-by-the-addition-of-funds-deposited-as-a-result-of-land--sales--and--mineral--royalty--payments~~ adjusted cumulatively as of June 30 of each fiscal year thereafter by adding the amount of funds deposited into the permanent endowment fund from and including July 1 of the preceding calendar year through and including the June 30 date of adjustment, from any of the following sources:

(i) Land sales proceeds not deposited into the land bank fund under section 58-133(2), Idaho Code;

(ii) Funds transferred from the land bank fund after expiration of the time frame under section 58-133(3), Idaho Code;

(iii) Mineral royalty payments; or

(iv) Such other deposits into the permanent endowment fund as are required by law or otherwise permitted to be added to the permanent endowment fund except for the following:

1. Deposits to make up for losses to the permanent endowment fund; and

2. Deposits of earnings reserves.

(d) Loss Recovery. Cumulative l~~L~~osses ~~to~~ in permanent endowment funds other than the public school permanent endowment fund ~~shall~~ may be made up from earnings reserve fund moneys that the state board of land commissioners determines will not be needed for administrative costs or scheduled distributions to each endowment's respective income fund. Cumulative l~~L~~osses ~~to~~ in the public school permanent endowment fund shall be made up as follows:

(~~a~~i) The state board of land commissioners may ~~annually~~ transfer any funds in the public school earnings reserve fund that it determines will not be needed for administrative costs or scheduled distributions to the public school income fund in the following fiscal year to the public school permanent endowment fund, to make up for all or part of any ~~prior~~ then existing cumulative losses in ~~value~~ the public school permanent endowment fund.

(~~b~~ii) If ~~funds-transferred-from-the-earnings-reserve-fund-are-insufficient-to-make-up-any-losses-in-value-to~~ a cumulative loss exists in the public school permanent endowment fund~~,-and-the-market-value-of-the-public-school-permanent-endowment-fund-at~~ as of the end of ~~each~~ a fiscal year, ~~remains-below-the~~ and there has also been a cumulative loss ~~benchmark-market-value~~ at the end of each of the preceding nine (9) fiscal years, for a total of ten (10) consecutive fiscal years ending with a cumulative loss, then, to the extent the then existing cumulative loss is not made up from transfers of earnings reserves under subsection (2)(d)(i) of this section, the legislature shall, ~~make-up-the-loss~~ by legislative transfer or appropriation authorized during one (1) or both of the next succeeding two (2) regular sessions of the legislature~~.~~, ~~Such-loss-to-be-made-up-shall-be~~ authorize a deposit to the public school permanent endowment fund in an amount equal to the lesser of: ~~the:~~

~~(i)~~1. The c~~C~~urrent cumulative loss; or

~~(ii)~~2. An amount not less than the a~~A~~nnual loss determined in the first year of the preceding ~~consecutive~~ ten (10) consecutive fiscal years, provided however, the legislature may offset the amount of this annual loss by any deposits of earnings reserves made by the land board into the public school permanent endowment fund after the end of the fiscal year for which such annual loss was calculated, but only to the extent any such deposit of earnings reserves has not been used previously to offset the amount of a prior legislative deposit under this subparagraph 2.

(~~c~~iii) The deposit of a~~A~~ny transfer~~s~~ or appropriation~~s~~ authorized by the legislature ~~for-deposit-into-the-public-school--permanent--endowment--fund~~ under subsection (2)(d)(ii) of this section shall take place ~~at~~ after the end of the fiscal year~~,-after-the-determination-of-gains-and-losses.-If-the-market-value-of-the-public-school--permanent-endowment--fund-exceeds-the-loss-benchmark-market-value-at-the-end-of-any-fiscal-year-in-which-legislative-transfers-or-appropriations--are-authorized--to--the-public-school-permanent-endowment-fund,-then-such~~

~~transfers-or-appropriations-shall-be-reduced-by-the-lesser-of-the:~~

~~(i)---Amount-that-the-market-value-of--the--public--school--permanent endowment--fund--would--exceed-the-loss-benchmark-market-value-at-the end-of-the-fiscal-year-if-all--authorized--legislative--transfers--or appropriations-were-to-be-made;-or~~

~~(ii)--Amount--of--the--legislative-transfers-or-appropriations-authorized-for-deposit-in-the-public-school-permanent-endowment--fund--for the--fiscal--year~~ in which the deposit was authorized by the legislature, and as soon as is practicable once the investment board has calculated the cumulative loss in the public school permanent endowment fund as of the end of the fiscal year; provided however, in the event the cumulative loss as of the end of such fiscal year is less than the amount of the authorized deposit, the deposit shall be reduced to an amount equal to the cumulative loss, and the balance of the authorized deposit shall be returned to the source of the deposit.

SECTION 2. An emergency existing therefor, which emergency is hereby declared to exist, the calculation of gain benchmark market value and loss benchmark market value set forth in this act shall be in full force and effect on and after its passage and approval, and shall be retroactive to June 30, 2000, and shall replace and supersede any prior calculation thereof.

STATEMENT OF PURPOSE

RS15860

This legislation makes minor adjustments to and clarifies the calculation of gains and losses to the state's endowment funds. It also clarifies the mechanism for recovery of losses to the endowments, including the constitutionally mandated recovery of losses to the Public School Permanent Endowment.

Endowment Gains.

Section 57-724(1) addresses calculation of gains to the permanent endowments for determining the amount of capital gains and other earnings to be transferred to the beneficiary's earnings reserve funds. The revisions to this section clarify the calculation of the "Gain Benchmark Market Value" for each endowment. The revisions to §57-724(1)(a) specifically describe the calculation of the inflation adjustment to the benchmark, which protects the endowment corpus from erosion of its purchasing power. The revisions to §57-724(1)(b) set out with greater specificity the deposits of funds which are intended to apply to increase the protected corpus of the endowment including a catch-all provision for other deposits. The catch-all provision contains exceptions to ensure that deposits made to make up endowment losses do not add to the gain benchmark and to allow for deposits to be made without raising the gain benchmark if the depositor so specifies. Lastly, §57-724(1)(c) establishes a floor below which the gain benchmark market value may not fall, to ensure that none of the permanent corpus of an endowment will be erroneously included in these gains, which might occur, for example, in a deflationary environment.

Under §57-724(1) the calculation is done in three steps. First, the Gain Benchmark Market Value is adjusted as of the end of each fiscal year for inflation which occurred during the fiscal year. The inflation adjustment is the Gain Benchmark Market Value at the opening of the fiscal year (which is also the closing value for the prior fiscal year after the applicable adjustment for inflation and deposits from the prior fiscal year) multiplied by the percentage change in the average CPI-U since the close of the prior fiscal year. Second, after the inflation adjustment is made, the Gain Benchmark Market Value is increased by the listed deposits made during the fiscal year. Third, the adjusted Gain Benchmark Market Value is compared to the actual market value of the endowment as of the end of the fiscal year. The net market gain for the fiscal year is the amount by which the actual market value exceeds the benchmark. This calculation is to be done as of the close of each fiscal year (June 30), but must be done after the fact since the information necessary to make the calculation will not be available until the completion of the fiscal year audit.

Endowment Losses.

Section 57-724(b) addresses calculation of losses to the endowments and the mechanism for making up those losses. The legislation now defines and sets out a calculation for the cumulative loss for each endowment (§57-724(2)(a)), as well as the annual loss for each endowment (§57724(2)(b)). The calculation of both cumulative and annual loss, if any, must be made each fiscal year that a cumulative loss exists. The calculation of the loss benchmark is clarified in §57-724(2)(c) by specifying those additions to the endowment which increase the underlying permanent corpus of the endowment, but specifically excepts deposits from earnings reserves (as per Section 3 Article IX of the Idaho Constitution) and deposits made to recover losses. It is important to note that even though the loss calculation mechanism applies to all endowments, only the public school permanent endowment carries the requirement under Article IX Section 3 of the Idaho Constitution which mandates that losses to that endowment be made up by the state. As to the other endowments, the land board has authority to make up losses with deposits of earnings reserves.

§57-724(2) provides the mechanism for the state to comply with the mandate in Article IX Section 3 of the Idaho Constitution to "supply losses to the public school permanent endowment fund." In the event this permanent fund has carried a cumulative loss for ten consecutive fiscal years (measured as of the end of each fiscal year), legislative appropriation or other transfer must be made into the permanent fund. This legislation clarifies the ten year term as the fiscal year for which the latest loss calculation has been made and the nine previous fiscal years. (§57-724(2)(d)(ii)) This legislation also clarifies the amount of the minimum appropriation or transfer and allows for appropriation or transfer of more than the minimum should the legislature choose. (§57-724(2)(d)(ii)(A) & (B)) The revisions also ensure that transfers from the earnings reserve fund by the Board of Land Commissioners are fully applied against any loss that would otherwise have to be made up by the legislature. Lastly, the legislation clarifies that a market recovery during the time allowed for the legislative deposit into the permanent fund can be credited against the deposit amount such that the legislature will never have to deposit more that what is necessary to make up the cumulative loss in the endowment as of the time of the deposit. (§57-724(2)(d)(iii)

Application of this legislation to the public school permanent endowment fund from June 30, 2000 through June 30, 2005 is shown in Attachment A hereto.

FISCAL NOTE

This bill is not intended to have a fiscal impact on the general fund or the endowments. Its purpose is to clarify the application of the existing statutes. The changes to the statutory language are intended to be revenue neutral, and to ensure that transfers from the earnings reserve fund by the Board of Land Commissioners are fully applied against any loss that would otherwise have to be made up from the general fund.

CONTACT
Name: Larry Johnson, Manager of Investments
Agency: Endowment Fund Investment Board
Phone: (208) 334-3311

A	B	C	D	E	F	G	H	I	J	K
		Gain Benchmark Statutory Gain						**Loss Benchmark Statutory Cumulative & Annual Loss**		
Attachment A Public School Permanent Endowment Fund - Benchmark Calculation Table	Actual Permanent Fund Balance	(a) Fiscal Year Average CPI-U	(b) Fiscal Year Average Percent Change	(c) Inflation Adjustment	Deposits to the Permanent Fund	(d) Adjusted Gain Benchmark Market Value	(e) Statutory Gain	(f) Loss Benchmark	(g) Statutory Cumulative Loss calculation	(h) Statutory Annual Loss
Beginning Balance 6/30/2000	$555,954,750	169.292				$555,954,750	$ -	$555,954,750		
Inflation Adjustment - 6/30/2001 Deposits - fy01 Adjusted Benchmark/Balance	$511,726,709	175.092	3.426%	$575,001,760	$1,742,339	$576,744,099	$ -	$557,697,089	$ (45,970,380)	$ (45,970,380)
Inflation Adjustment - 6/30/2002 Deposits - fy02 Adjusted Benchmark/Balance	$441,549,031	178.192	1.771%	$586,952,469	$1,369,675	$588,322,144	$ -	$559,066,764	$(117,517,733)	$ (71,547,353)
Inflation Adjustment - 6/30/2003 Deposits - fy03 Adjusted Benchmark/Balance	$436,160,539	182.108	2.198%	$601,253,465	$2,190,628	$603,444,093	$ -	$561,257,392	$(125,096,853)	$ (7,579,120)
Inflation Adjustment - 6/30/2004 Deposits - fy04 Adjusted Benchmark/Balance	$500,618,909	186.092	2.187%	$616,647,450	$ 840,648	$617,488,098	$ -	$562,098,040	$ (61,479,131)	none
Inflation Adjustment - 6/30/2005 Deposits - fy05 Adjusted Benchmark/Balance	$537,181,394	191.692	3.009%	$636,068,315	$1,551,570	$637,619,885	$ -	$563,649,610	$ (26,468,216)	none

(a) Sum of the fiscal year monthly CPI-U figures divided by 12. See CPI-U Table below.
(b) Current fiscal year average CPI-U less prior fiscal year average CPI-U divided by prior fiscal year average CPI-U – ((Current Year C less Prior Year C) / Current Year C).
(c) Beginning Adjusted Gain Benchmark multiplied by 1+ Fiscal Year Average Percent Change – (Prior Year G * (1+D)).
(d) Inflation Adjustment plus Deposits to the Permanent Fund - (E+F).
(e) Excess of Actual Balance over Gain Benchmark – (G-B). Note that there has not yet been a statutory gain.
(f) Beginning Balance + deposits – (Prior Year Benchmark I + Current Year Deposits F).
(g) Actual Fund Balance – Loss Benchmark – (B-I).
(h) Increase in Cumulative Loss from Prior Year Cumulative loss.

Consumer Price Index-All Urban Consumers

Not Seasonally Adjusted
Area : U.S. city average
Item : All items
Base Period : 1982-84=100

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1999	164.3	164.5	165	166.2	166.2	166.2	166.7	167.1	167.9	168.2	168.3	168.3
2000	168.8	169.8	171.2	171.3	171.5	172.4	172.8	172.8	173.7	174	174.1	174
2001	175.1	175.8	176.2	176.9	177.7	178	177.5	177.5	178.3	177.7	177.4	176.7
2002	177.1	177.8	178.8	179.8	179.8	179.9	180.1	180.7	181	181.3	181.3	180.9
2003	181.7	183.1	184.2	183.8	183.5	183.7	183.9	184.6	185.2	185	184.5	184.3
2004	185.2	186.2	187.4	188	189.1	189.7	189.4	189.5	189.9	190.9	191	190.3
2005	190.7	191.8	193.3	194.6	194.4	194.5	195.4	196.4	198.8	199.2	197.6	

LEGISLATURE OF THE STATE OF IDAHO
Fifty-eighth Legislature Second Regular Session - 2006

IN THE ____________________

__________ BILL NO. __________

BY ____________________

AN ACT

RELATING TO THE INVESTMENT OF PERMANENT FUNDS; REPEALING SECTIONS 3 AND 5, CHAPTER 132, LAWS OF 2004, REGARDING THE DEFINITION OF "EARNINGS DEFINED" AND THE EFFECTIVE DATE OF THE ACT; AND AMENDING SECTION 57-724A, IDAHO CODE, TO PROVIDE FOR CALCULATION OF GAINS ACHIEVED BY THE PERMANENT FUND OF EACH ENDOWMENT FUND TO BE INCORPORATED INTO THE CALCULATION OF GAINS AND NOT BE A SEPARATE ITEM OF EARNINGS.

Be It Enacted by the Legislature of the State of Idaho:

SECTION 1. That Sections 3 and 5, Chapter 132, Laws of 2004, be, and the same are hereby repealed.

SECTION 2. That Section 57-724A, Idaho Code, be, and the same is hereby amended to read as follows:

57-724A. EARNINGS DEFINED. "Earnings" shall mean all revenues generated from the management of endowment lands and their related endowment funds including, but not limited to, timber sale proceeds, lease fees, interest, dividends, and gains as defined in section 57-724, Idaho Code<u>; provided however, for the permanent fund of each endowment, on and after July 1 of the calendar year following the first calendar year in which gains, as calculated under the provisions of section 57-724, Idaho Code, have been achieved by the permanent fund of such endowment fund, dividends and interest shall be incorporated into the calculation of gains as defined in section 57-724, Idaho Code, and shall not be a separate item of earnings for such permanent fund</u>. "Earnings" does not include mineral royalties or land sale proceeds.

STATEMENT OF PURPOSE

RS 15838

The State of Idaho has eight permanent endowment funds. Under the law currently in effect, dividends and interest earned by these permanent funds are deposited directly into the earnings reserves for each fund and are then immediately available for distribution to the beneficiaries according to the endowment's distribution schedule. In 2004, the legislature passed Senate Bill 1306 to change the definition of earnings for these permanent endowment funds to incorporate dividends and interest into the annual gain calculation for each fund. This change will eliminate the direct deposit of interest and dividends into the earnings reserves and instead incorporate them into the year end calculation of gain based on the overall market value of the permanent fund. Under SB 1306, the effective date of the change is as of the first day of the fiscal year following the year in which the public school permanent endowment fund first exceeds the gain benchmark established under Section 57-724, Idaho Code (i.e. June 2000 value adjusted for inflation and certain deposits).

The revenues of the endowment funds vary widely, as do their respective gain benchmarks. A permanent endowment fund may not first achieve a statutory gain by the year in which the public school permanent endowment fund first achieves a gain. If interest and dividends are not available for distribution and the permanent endowment fund has not achieved a statutory gain, the earnings reserve fund for the endowment may not have enough funds available to make scheduled distributions.

This bill establishes a triggering event for the change in the definition of earnings on an individual endowment fund basis rather than tying each endowment to the public school endowment. It also allows for at least one legislative session to occur between the time the triggering event occurs and the new definition of earnings takes effect. This will provide adequate time for the Endowment Fund Investment Board and the Board of Land Commissioners, as trustees of the endowments, to review whether an adjustment to the beneficiary's distributions is appropriate once the triggering event has occurred, and will also allow the Legislature to take any such adjustment into account in the appropriations process for the beneficiary.

FISCAL IMPACT

This legislation has no direct impact on the general fund. However, it reduces the likelihood that there will be a shortfall in expected distributions from the endowment fund, and therefore reduces the likelihood that general fund revenues will be requested to make up that shortfall.

CONTACT
Name: Larry Johnson, Manager of Investments
Agency: Endowment Fund Investment Board
Phone: (208) 334-3311

Statement of Purpose/Fiscal Impact H ____